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No. _____

IN THE

Supreme Court of the United States

October Term, 1980

Metropolitan Detroit Area Hospital Services, Inc.,
Petitioner,
v.
United States of America,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

(1) Whether a non-profit corporation controlled by and operated solely for the benefit of its members, all of which are tax-exempt charitable hospitals within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954, as amended, (the "Code"), and whose only activity is providing linen and laundry services to those tax-exempt members, is itself a charitable organization exempt from taxation under Sections 501(a) and 501(c)(3) of the Code.

(2) Whether an organization, which is exempt from taxation under Section 501(a) of the Code, is denied exemption because of the later enactment of Section 501(e) of the Code.

(3) Whether Section 501(e) of the Code is the exclusive section under which tax-exempt hospitals may jointly organize and operate non-profit shared service organizations and obtain federal tax-exempt status.

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To The Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Metropolitan Detroit Area Hospital Services, Inc., a Michigan non-profit corporation, by its attorneys, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit filed November 4, 1980.

OPINIONS BELOW

The Order of the United States District Court for the Eastern District of Michigan, Southern Division, dated February 9, 1980 in favor of Metropolitan Detroit Area Hospital Services, Inc., is printed at pages A-1 to A-17, infra, and reported at 445 F. Supp. 857 (E.D. Mich. 1978). The Opinion of the United States Court of Appeals for the Sixth Circuit reversing the District Court was filed November 4, 1980 (Nos. 78-1205, 78-1218), is printed at pages B-1 to B-12, infra, and its reported at 47 A.F.T.R. 2d ¶ 81-303; 80-2 U.S.T.C. ¶ 9012 (6th Cir. 1980). The Judgment of the Court of Appeals filed November 4, 1980 is printed at page C-1, infra, and is not officially reported.

JURISDICTION

The date of the Judgment of the Sixth Circuit Court of Appeals sought to be reviewed is November 4, 1980 which is also the date of its entry. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

(1) Internal Revenue Code of 1954, Title 26 United States Code, Section 501 the pertinent portions of which are as follows:

> § 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.
>
> (a) EXEMPTION FROM TAXATION. — An organization described in subsection (c) or (d) or

section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * *

(c) LIST OF EXEMPT ORGANIZATIONS. — The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or education purposes, . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

(e) COOPERATIVE HOSPITAL, SERVICE ORGANIZATIONS. — For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if —

(1) such organization is organized and operated solely —

(A) to perform, on a centralized basis, one or more of the following services which,

if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is —

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constitutent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates

> or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and
>
> (3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.
>
> For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

(2) Treasury Regulation Section 1.501(c)(3)-1(d)(2) provides in pertinent part:

> (2) Charitable defined. The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions . . .

(3) Treasury Regulation Section 1.502-1(b) provides:

> (b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a

tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For purposes of this paragraph, organizations are related only if they consist of —

(1) A parent organization and one or more of its subsidiary organizations; or

(2) Subsidiary organizations having a common parent organization.

An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities.

STATEMENT OF THE CASE

This case involves a suit for refund of federal income taxes paid for the taxable years 1973 and 1975 on the grounds that Petitioner is a charitable organization within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954, as amended (the "Code") and therefore exempt from taxation under Section 501(a) of the Code.

Petitioner, Metropolitan Detroit Area Hospital Services, Inc., ("Metropolitan"), is a non-profit Michigan corporation, which was incorporated in 1970. Metropolitan is organized and operated solely to provide central linen and laundry services solely for its four member hospitals ("member"). Metropolitan is controlled by and operated solely for the benefit of its member hospitals. Each member hospital is a non-profit charitable hospital within the meaning of Section 501(c)(3) of the Code and therefore exempt from taxation under Section 501(a) of the Code. Only hospitals which are themselves charitable organizations within the meaning of Section 501(c)(3) of the Code and exempt from taxation are eligible to become members of Metropolitan.

Petitioner's purposes, as set forth in its Articles of Incorporation, are solely charitable, scientific and educational for the benefit of its members. No net earnings of Metropolitan have inured to the benefit of any private person, firm or corporation, and in the event of dissolution, all of Petitioner's assets are required to be distributed solely to tax-exempt charitable organizations within the meaning of Section 501(c)(3) of the Code and therefore exempt from taxation under Section 501(a) of the Code.

Metropolitan was organized to reduce costs for its member hospitals by eliminating the need for each hospital to maintain its own separate laundry facility and linen supply. Metropolitan's linen and laundry services are unique and have been specificially designed to insure sanitary standards and controls necessary for the member hospitals. Metropolitan performs an integral function of each of its member hospital's charitable operations. It is impossible for a hospital to discharge its purposes without a laundry and linen service.

Metropolitan derives its revenues from fees charged to its members based on the services provided to each member. Fees charged are determined by ascertaining a cost per pound of laundry which takes into account all current operating costs and debt amortization. Metropolitan does not make a profit on fees charged to members. The services performed by Metropolitan have substantially reduced the overall cost of laundry and linen services to member hospitals, thereby resulting in a reduction in the overall cost of health care in Detroit. Each of Metropolitan's members has received a benefit by virtue of its membership in Metropolitan including reduced linen and laundry costs and increased floor space for medical activities.

Metropolitan is exempt from Michigan state *ad valorem* real and personal property taxes by virtue of M.C.L.A. § 211.7, § 211.9(a) and *Hospital Purchasing Service* vs. *City of Hastings*, 11 Mich. App. 500, 162 N.W. 2nd 759 (1968). Further, Metropolitan, is exempt from Michigan sales and use taxes pursuant to M.C.L.A. § 205.5(a). This exemption arises by virtue of the fact that Metropolitan's sole activity is to perform services for its member hospitals, all of which qualify as non-profit entities exempt from Michigan's sale and use tax laws.

On April 17, 1975, Metropolitan filed an application for recognition of tax exempt status with the Internal Revenue Service. By letter dated September 1, 1976, Internal Revenue Service denied Metropolitan's application. Metropolitan filed income tax returns for its fiscal years ended October 31, 1973 and October 31, 1975 in a timely fashion in the manner prescribed by law and paid the tax shown to be due. On October 26, 1976, Metropolitan filed claims for refund for these taxes paid. Metropolitan's claims for refund were rejected by the Internal Revenue Service on February 11, 1977. Metropolitan had no income tax liability for its fiscal year ended October 31, 1974.

On April 1, 1977, Metropolitan commenced this action in the District Court seeking a refund for federal income taxes paid for its taxable years 1973 and 1975. Furthermore, Metropolitan requested that it be declared a charitable organization within the meaning of Code Section 501(c)(3), therefore exempt from federal income taxes under Section 501(a) of the Code. Jurisdiction in the District Court was based on 28 U.S.C. § 1346.

On October 6, 1977 Metropolitan moved for summary judgment. Metropolitan's motion was opposed by the Government. The District Court granted judgment in favor of Metropolitan, holding that Metropolitan was a charitable organization within the meaning of Section 501(c)(3) of the Code and thereby exempt from taxation under Section 501(a) of the Code. The Sixth Circuit reversed the District Court by a decision holding that rather than providing a "safe harbor" for such organizations, Section 501(e) provides the sole and exclusive provision of the Code which provides an exemption for hospital shared service organizations. Metropolitan has never claimed to be exempt under

Section 501(e) of the Code. Metropolitan claims to be a charitable organization within the meaning of Section 501(c)(3) and therefore exempt from taxation under Section 501(a) of the Code.

ARGUMENT

The import of this petition for writ of certiorari rests not only on the case's obvious and immediate impact on Metropolitan. In fact, the case presents an extremely important issue in the federal tax law applicable to a wide range of tax-exempt organizations namely, the ability of tax-exempt hospitals and health care organizations to band together in cost saving shared service organizations. The magnitude of the issue presented in the instant case is demonstrated by the fact that there are currently before this court two petitions for certiorari on cases involving the identical issue [see *HCSC – Laundry* v. *The United States of America*, 473 F. Supp. 250 (E.D. Pa 1979), rev'd 624 F.2d 428 (3d Cir. 1980), 49 U.S.L.W. 3165 (No. 80-338) *Hospital Central Services Association* v. *The United States of Amercia, supra*] as well as the wide number of cases involving this issue in federal district courts across the country and in the United States Court of Claims. The Supreme Court's attention should be directed to this issue, thus insuring orderly and consistent administration of the tax laws.

The decision of the Sixth Circuit Court of Appeals in this case is based on the mistaken conclusion that Congress intended Section 501(e) of the Code to be the exclusive vehicle for tax exemption for hospital shared service organizations. In reaching its conclusion, the Circuit Court relied in part upon the decision of the Third Circuit Court of Appeals in *HCSC – Laundry* v. *The United States of America, supra,* and the decision of the

Ninth Circuit Court of Appeals in *Hospital Central Services Association* v. *The United States of America, supra.* Both decisions erroneously conclude that in 1968, when Congress enacted Section 501(e) of the Code, as evidenced by that Section's legislative history, it thereby denied a non-profit corporation, whose members are all tax-exempt hospitals, from qualifying for tax-exempt status as a "charitable organization" under Section 501(c)(3). This conclusion is contrary to the express language of Section 501 of the Code and the decision of the United States Court of Claims in *Northern Cal. Cent. Services, Inc,* v. *United States,* 591 F.2d 620 (Ct. Cl. 1979), as well as numerous District Court and state court decisions. In addition, denial of tax-exempt status to joint hospital shared laundries, such as Petitioner, will substantially increase the overall costs of health care services in the United States which is contrary to established federal policy.

In reaching its conclusion, the Circuit Court ignored the expressed wording of the statute in question and chose instead to rely upon an inconclusive legislative history of Congress' "intent" in adding Section 501(e) to the Code.

1. The Language of Code Section 501(e) Does Not Deny Exemption to Hospital Shared Service Organizations Which Meet the Stringent Requirements of Code Sections 501(c)(3) and 501(a).

It is clear that there is nothing in the express language of Code Sections 501(a), 501(c) or 501(e) which prohibits hospital shared service organizations from qualifying for exemption under the general charitable provisions of

Code Section 501(c)(3). The statutory scheme is for initial grant of exemption under Code Section 501(a):

> "(a) EXEMPTIONS FROM TAXATION — An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under Section 502 or 503."

Subsection 501(c)(3) describes as exempt those organizations which are "organized and operated exclusively for . . . charitable . . . purposes." Subsection 501(e), on the other hand, specifically enumerates certain cooperative hospital service organizations as being operated for a charitable purpose. The language of Section 501(e) provides only that an organization which carries on one of the enumerated activities for hospitals on a cooperative basis shall be treated as a charitable organization. The language of 501(e) does not deny exemption to shared service organizations which might be able to qualify for the exemption of Code Section 501(a) for a variety of reasons.

If Metropolitan is a charitable organization, within the meaning of Section 501(c)(3) of the Code, its exemption may only be denied under Sections 502 or 503 of the Code. Its exemption cannot be denied under Section 501(a). *Hospital Bureau of Standards and Supplies* v. *United States of America*, 158 F.2d Supp. 560 (Court of Claims 1958); *United Hospital Services Inc.*, v. *United States of America*, 384 F.2d Supp. 776 (Southern District Indiana 1974). The effect of the Sixth Circuit decision in Metropolitan's case is to prevent any charitable organization that performs hospital services jointly for more than one non-profit tax-exempt hospital from itself obtaining tax-exempt status unless it is also listed in Code Section 501(e). Such a result is decidedly at odds

with the specific words of the statute in question. The government has yet to point to a single word in any of the statutes before this Court in support of this anomalous result.

Nowhere has the Congress of the United States decreed that laundry activities jointly carried on by tax exempt hospitals, solely for their own needs, must be denied exemption from tax. Although the statute does not provide such denial, the Sixth Circuit below found this result to be imposed based on implications drawn from legislative history occuring some sixty-five years after Congress first extended tax exemption via the broad language of Section 501(c)(3) to any orgainzation organized and operated exclusively for charitable purposes. Had Congress affirmatively intended to tax hospital shared service laundries, the Internal Revenue Code would surely have so provided. This Court should not allow the imposition of a tax which has not been mandated by Congress.

2. The Total History of Code Section 501(e) Shows That Its Enactment Was Intended as a "Safe Harbor" and Not as an Exclusive Means to Tax-Exempt Status of Share Service Organizations.

As noted above, the Sixth Circuit Court relied extensively upon the legislative history surrounding the enactment and revision of Code Section 501(e) in support of its decision. A complete review of the history of the taxation of hospital shared service organizations does not, however, indicate Congressional intent to preclude Metropolitan from tax-exempt status under Code Section 501(c)(3).

The reported history of hospital shared service organizations' quest for tax-exempt status dates from the year 1954 when the Internal Revenue Service unillaterally attempted to preclude all hospital shared service organizations from tax-exempt status by issuing *Revenue Ruling 54-304*, 1954-2. C.B. 127. That ruling dealt with the question of whether an organization purchasing supplies for its member charitable hospitals was exempt. The Service concluded that it was not because its activities were described as a "trade or business" since they were carried out on a shared service basis among unrelated hospitals.

The Service enforced this position administratively. In 1958, this resulted in the case of *Hospital Bureau of Standards & Supplies* v. *United States, supra*. In *Hospital Bureau* a group of 207 hospitals organized a non-profit corporation to jointly purchase supplies for its members, thereby realizing savings not possible with individual purchases by each hospital. The Government denied exemption to the corporation, raising arguments virtually identical to those it advocated in the Court below:

> (a) The Government argued that purchasing and distributing supplies is a proprietary business and is not a charitable or hospital function.
>
> (b) The Government argued that since the purchasing and distributing of supplies was carried on at a "profit" (which was distributed among members at the end of each quarter), its activities were taxable.
>
> (c) The Government argued that Treasury Regulation 111, § 29.101-3(b) prohibited

shared service activities among tax-exempt organizations from qualifying as exempt organizations.

(d) The Government argued that the plaintiff was engaged in a trade or business and hence as a taxable "feeder organization."

The Court of Claims carefully rejected each of the Government's claims and held that the shared service organization was entitled to tax-exempt status. Thus, it is clear that on virtually every ground upon which it attacked Metropolitan's exemption in the Courts below, the Government had argued and lost as early as 1958.

The difficulty, of course, is that the Internal Revenue Service has the luxury of disregarding its judicial losses while continuing to administer the tax laws in accordance with its own interpretation. This is exactly what it did. Even afater the Court of Claims' decision in the *Hospital Bureau of Standards* case, the Internal Revenue Service continued to deny exemption to hospital membership organizations which sought cost-savings through shared services. In the 1960's it was clear that in each case where hospitals sought such savings, they would be forced into costly litigation.

By 1967 the situation had become sufficiently serious that the American Hospital Association sought to remove the *practical* barrier which the Internal Revenue Service's adverse administrative position presented by seeking corrective legislation in Congress. Hospitals were interested in effecting savings through shared services but could not afford to litigate the hostile Internal Revenue Service position over tax-exempt status on a case by case basis. A primary interest of hospitals was in the area of laundry and linen services because of the very

large savings which were available in this service. At the urging of the American Hospital Association, legislation was introduced in Congress in 1967 which provided that all shared service activities of hospitals would be tax-exempt, thereby negating the Internal Revenue Service's administrative position for these activities but leaving it for the courts to decide under Section 501(c)(3) whether shared service activities of other exempt organizations such as schools, churches, etc. might be exempt. The provision passed the Senate as part of the Social Security Amendment Act of 1967, P.L. 90-248, 81 Stat. 821. It was, however, deleted in Conference Committee under heavy lobbying pressure by organizations representing commercial laundry interests.

A provision seeking relief from the erroneous Internal Revenue Service administrative position was again introduced in 1968 as a part of the Revenue Act of 1968 and eventually was enacted into law as Code Section 501(e). In the course of enactment, however, intensive lobbying pressure by commercial laundries resulted in hospital laundry activities being excluded from those activities to which specific legislative relief was granted.

The relief extended by Congress in Code Section 501(e) was a "safe harbor" of relief from the erroneous administrative position with respect to hospital shared services which the Internal Revenue Service had taken. It was not, as the Government argues, an endorsement of that position.

The continued escalating costs of in-house or commercial laundry services drove hospitals again to carry their fight for laundry services to the courts, notwithstanding their inability to obtain legislative relief in 1967 and 1968 against the adverse administrative

position of the Internal Revenue Service regarding this activity. Accordingly, in 1974 United Hospital Services, Inc., an organization operated by five public or non-profit hospitals in Indianapolis, Indiana, to perform their laundry went to court to challenge the Internal Revenue Service administrative position denying them exemption. See *United Hospital Service, Inc.* v. *United States, supra*.

The Government's arguments in opposing United Hospital Services' request for exemption were the same as those advanced and rejected 16 years earlier in *Hospital Bureau of Standards, supra*. A new and clever argument, however, was added. The Internal Revenue Service in this case for the first time sought to "bootstrap" its position by contending that the original (and judicially rejected) administrative position regarding hospital shared services had been vindicated, and indeed enacted into law, when the efforts of the American Hospital Association to have Congress overturn the erroneous Internal Revenue Service administrative position failed with respect to laundry services. The District Court in *United Hospital* quickly rejected this "bootstrap" argument and granted exemption to the hospital laundry.

Again, the response by the Internal Revenue Service was simply to continue disregarding its judicial losses, maintaining its adverse adminstrative position regarding hospital shared service laundries. It freely granted exemptions under Section 501(c)(3) to all types of organizations engaged in proprietary activities associated with charitable purposes, however, steadfastly refusing to budge with regard to the area of hospital laundries, maintaining that this was a special case that Congress intended to be taxable.

In 1976, the American Hospital Association again attempted to get Congress to intervene on their behalf against the Internal Revenue Service by extending Section 501(e) to include laundry activities. Again, in the face of heavy lobbying pressure by commercial laundry interests, Congress refused to intervene, leaving the issue to be decided on a case by case basis in the courts.

The response of hospitals was to turn once more to the courts for relief. Hospital Central Services Association, a non-profit corporation in Seattle, Washington performing laundry services for its member tax-exempt hospitals also challenged the administrative position of the Internal Revenue Service by claiming tax-exempt status. The plaintiff moved for summary judgment. The Government went through its arguments of proprietary activity, realized "profit," feeder organization, and implied prohibition under Section 501(e). The Court rejected them all and accordingly granted tax exemption.

This brings us to the present situation. Hospitals throughout the entire United States are burdened with mounting financial costs. As Metropolitan's case so clearly demonstrates, substantial savings are available through the joint performance of laundry activities. The problem continues to center on the narrow and erroneous administrative position taken in 1954 by the Internal Revenue Service with respect to Section 501(c)(3).

The problem arose 27 years ago when the Service improperly resisted hospital shared service activities on the ground that they serve no charitable purpose. This argument was rejected in 1958 but the Service's position did not change. The American Hospital Association asked Congress to intervene and to give legislative relief from this position. The intervention resulted in partial

success under Section 501(e), but lobbying efforts precluded hospital laundry activities from being included. The Government now is trying to construe the refusal of Congress to intervene in the administrative dispute between the Internal Revenue Service and hospital laundries under Section 501(c)(3) as an explicit affirmance of the Internal Revenue Service position.

What has actually occurred in Congress is that Code Section 501(e) has been enacted to provide a safe harbor to the Internal Revenue Service's adverse administrative position with respect to certain hospital shared services activities. With respect to laundry and linen services, however, there occurred a legislative standoff between the proponents of hospital shared service laundries and the position advocated by commercial laundry interests. Unable to agree that specific relief should be extended for laundry activities, Congress merely left this issue, along with all other shared service activities undertaken by exempt organizations, for decision by courts under Section 501(c)(3), right where it stood in 1958.

Construed against the background of this 27 year struggle between the Internal Revenue Service and hospital shared service organizations, it is clear that Congress has expressed no intent whatsoever that the laundry activities be denied exemption. Congress has simply taken the posture of refusing either to impose specific taxation on hospital laundries or to grant them specific exemption by express statutory edict.

In enacting Section 501(e), Congress was responding to a problem. That problem was the continued adherence by the Internal Revenue Service to an erroneous administrative position regarding hospital shared service activities which had already been judicially rejected. Congress intended to correct this, but was able to agree

only with regard to certain activities. This left all others in the position of status quo. Code Section 501(e) means no more and no less than this.

3. The Issue Presented in This Case Impacts a Broad Range of Organizations and Its Resolution Is Imperative to the Uniform Administration of Federal Tax Laws.

In the past 10 years there has been a substantial increase in the number of central laundry organizations providing services to their tax-exempt hospital members. The amount of potential federal income taxes and resulting hospital costs is substantial. As a result, numerous cases have generated conflicting decisions. These cases involve an important question of federal tax law which has not been, but should be, settled by this Court.

In 1979 in *Northern Cal. Cent. Services, Inc.* v. *United States, supra*, the United States Court of Claims held that a non-profit corporation, which provided shared laundry services to its non-profit tax-exempt hospital members, was a charitable organization within the meaning of Section 501(c)(3) and exempt from taxation under Section 501(a) of the Code. The Court of Claims expressly rejected the Government's argument that the taxpayer must qualify, if at all, under Section 501(e) of the Code. *Northern Cal. Cent. Services, Inc., id*, is in direct conflict with the Sixth Circuit Court of Appeals in this case and the Courts of Appeals for the Third and Ninth Circuits.

Because of the recurring importance of the issue and the conflict between the Court of Claims, a court of co-equal rank with the Circuit Courts, and three Circuit Courts, this Court should grant certiorari. *United*

States v. *Zacks*, 375 U.S. 59 (1963). This case presents appropriate reasons for a review on writ of certiorari under Rule 17 of this Court.

The Tax Court has done little to quell what it has identified as the "long and stormy" tax history of hospital laundry service organizations. In *Associated Hospital Services, Inc.* v. *Commissioner*, 74 T.C. No. 17 (May 6, 1980), *appeal docketed*, No. 80-3596 (5th Cir. June 4, 1980), the Tax Court held that a laundry service organization owned and operated by several tax-exempt hospitals was not tax-exempt based upon Treasury Regulation 1.502-1(b) relating to feeder organizations. This decision did not reach the issue relating to Section 501(e) of the Code and is otherwise of little value in light of the concurring opinions by two judges and the two separate dissenting opinions by four judges. Even the Tax Court majority felt "constrained by the weight of legislative history" to reject its inclination to hold the organization tax-exempt. This case is now on appeal to the Court of Appeals for the Fifth Circuit.

All of the District Courts which have considered the same issue have held that Section 501(e) is not exclusive and that non-profit organizations such as Metropolitan are charitable organizations within the meaning of Section 501(c)(3) of the Code and therefore exempt from taxation under Section 501(a) of the Code. *United Hospital Services, Inc.* v. *United States, supra*; *Community Hospital Services, Inc.* v. *United States*, 43 A.F.T.R. 2d 79-934; 79-1 U.S.T.C. ¶ 9301 (E.D. Mich 1979), *rev'd*, unpublished opinion dated January 13, 1981; *Chart Inc.* v. *United States*, 491 F. Supp. 10 (D. D.C. 1979), *appeal docketed*, Nos. 80-1138 and 80-1339 (D.C. Cir. April 14, 1980); *HCSC-Laundry* v. *The United States of America, supra;*

Hospital Central Services Association v. *United States, supra*. Similar issues are now pending in other District Courts and the Court of Claims.

Similarly, numerous state court decisions have concluded that a non-profit corporation formed solely for the purpose of providing services to its tax-exempt hospital members is exempt from state real and personal property taxes. See, *Hospital Purchasing Service* v. *City of Hastings, supra*. Although an exemption under Section 501(a) of the Code does not depend upon state law, *Treasury Regulation* § *1.501(c)(3) 8 1(d)(2)* specifies that the word "charitable" is to be defined in its generally accepted legal sense.

Hospital laundry service is a sensitive matter. If not performed with sufficient quality controls, it can be the means of spreading diseases that hospitals hope to contain or cure. Petitioner provides its member hospitals with linen and laundry services at less cost and under more sanitary conditions than other available laundries. Each non-profit hospital could maintain its own laundry at a greater cost and operate with tax-exempt status. Whether each hospital launders its own linens or has that duty performed by a separate organization which it in part controls should be of no tax significance. If the activity is tax-exempt when conducted by the individual tax-exempt hospital, it does not become a non-exempt activity simply because it is spun off to a central laundry owned by the tax-exempt members. Shared laundry services are an essential part of the cost containment efforts favored by Congress in the area of health care services. See *Virginia Professional Standards Review Foundation* v. *Blumenthal*, 466 F. Supp. 1164 (D. D.C. 1979).

CONCLUSION

There now exists a conflict between the Court of Claims and the Third, Ninth and Sixth Circuits. The same issues are also pending on appeal to the Fifth Circuit, and the Court of Appeals for the District of Columbia. Petitioner, and other similar entities, are charitable organizations within the meaning of Section 501(c)(3) of the Code and exempt from taxation under Section 501(a). An organization exempt under Section 501(c)(3) of the Code cannot be denied exemption because of Section 501(e). The legislative history does not support the result reached by the Sixth Circuit. This Court should grant certiorari to resolve the conflict between the Circuit Courts of Appeals and the Court of Claims in order to provide for the uniform administration of the federal tax laws.

Respectfully submitted,

Gregory L. Curtner,
Counsel of Record

Stevan Uzelac
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MILLER, CANFIELD, PADDOCK
AND STONE
Counsel to Petitioner

APPENDIX A

(United States District Court
Eastern District of Michigan
Southern Division)

(Metropolitan Detroit Area Hospital Services, Inc., a Michigan non-profit corporation, Plaintiff, v. United States of America, Defendant. Civil Action No. 7-70794)

OPINION

Plaintiff, Metropolitan Detroit Area Hospital Services, Inc. (Metropolitan) is a non-profit corporation owned and operated cooperatively by six Detroit area hospitals; its purpose is to provide laundry services to those hospitals. Prior to the incorporation of Metropolitan on June 15, 1970, each participating hospital maintained separate "in-house" laundry facilities to furnish services now provided by Metropolitan. In essence, the hospitals pooled their resources to form the laundry cooperative and now pay to Metropolitan a rate designed to cover the laundry's costs and overhead, including debt retirement. Metropolitan is controlled by a Board of Trustees the members of which are appointed by the governing bodies of the participating hospitals. Each hospital appoints two members to the Board of Metropolitan.

Although presently Metropolitan provides laundry services only, its Articles of Incorporation allow for a significant expansion of hospital services. Each participating hospital is exempt from federal income tax because of Int. Rev. Code of 1954, § 501(a)(3); 26 U.S.C. 501(c)(3), or is publically owned and operated as a

municipal corporation. Metropolitan is exempt from Michigan *ad valorem* personal and real property taxes and from Michigan sales tax. M.C.L.A. 211.7; *Hospital Purchasing Service v. City of Hastings*, Mich. App. 500, 161 N.W.2d 759 (1968).[1]

In 1973 Metropolitan paid $4,811.00 in federal income taxes. The pleadings do not show what amount, if any, Metropolitan paid in income taxes for 1974. In 1975 it paid $39,822.00. On April 17, 1975 Metropolitan filed with the Internal Revenue Service an application for recognition of exemption, asserting that it was a charitable organization under Int. Rev. Code § 501(c)(3); 26 U.S.C. 501(c)(3) and, thus, entitled to federal income tax exemption because of Int. Rev. Code § 501(a); 26 U.S.C. 501(a). IRS denied it an exemption on September 1, 1976, and upon receipt of Metropolitan's letter of protest on November 4, 1976, IRS formally restated its previous position denying Metropolitan a tax exemption. Metropolitan received this letter on or about December 26, 1976.

Metropolitan also filed a claim for refund in an amended U.S. corporation income tax return, dated October 26, 1976. To support this claim it furnished supplemental information to the IRS in a letter dated November 12, 1976. IRS, however, found insufficient grounds upon which to reduce Metropolitan's tax liability and so informed Metropolitan on February 11, 1977.

On April 1, 1977 Metropolitan filed its complaint in this court against the IRS to recover $44,633.00. It now seeks summary judgment, pursuant to F.R.C.P. 56, and contends there is no genuine issue as to any material fact

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[1] In this case no appeal was taken to the Michigan Supreme Court.

and that it is entitled, therefore, to judgment in its favor as a matter of law. I agree.

The facts as stated are not disputed by the parties. The only question demanding resolution is whether, under these facts, the plaintiff is entitled to a federal income tax exemption under Section 501(a) because of Section 501(c)(3) of the Internal Revenue Code. Although this question is singular, it must be analyzed in three parts. First, is plaintiff, as a cooperative organization owned and operated by tax exempt hospitals, entitled to claim a tax exemption under Section 501(c)(3) of the Internal Revenue Code, or must it qualify for an exemption, if at all, under the more narrowly draw Section 501(e)? Second, is plaintiff a charitable organization within the meaning of Section 501(c)(3) and, therefore, entitled to a Section 501(a) exemption? Third, is plaintiff a feeder organization under Section 502 and, therefore, not entitled to an exemption under Section 501(a)?

I.

Section 501(a) of the Internal Revenue Code provides generally for certain tax exemptions:

> An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

Plaintiff contends that since it is a charitable organization as described in Section 501(c)(3), it is entitled to a Section 501(a) exemption. Section 501(c)(3) provides:

> (c) List of exempt organizations. — The following organizations are referred to in subsection (a):
>
> * * *

> (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Defendant counters this argument in part by maintaining that plaintiff, as a cooperative hospital service organization, must qualify for exemption, if at all, under Section 501(e), rather than under Section 501(c)(3). Section 501(e) provides:

Cooperative hospital service organizations. — For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if —

(1) such organization is organized and operated solely —

> (A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for

its exemption: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel), services; and

(B) to perform such services solely for two or more hospitals each of which is —

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a).

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii)owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

> For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in selection 170(b)(1)(A)(iii).

Defendant argues that since laundry services is not included in the list of exempt hospital services in Section 501(e), plaintiff cannot received a Section 501(a) exemption.

Plaintiff responds, and with this I agree, that as to cooperative hospital service organizations, Section 501(e) contains a list of exempt organizations additional to those included in Section 501(c) and is not, as defendant maintains, an exclusive list. In *United Hospital Services, Inc. v. United States*, 384 F. Supp. 776 (S.D. Ind. 1974), Judge Dillin took the identical position:

> The government argues that the addition of what is now Section 501(e) in 1968 clearly shows the intent of Congress to exclude hospital laundry service organizations from being treated as charitable organizations under Section 501(c)(3). Section 501(e) provides that cooperative hospital service organizations will qualify for exemption if they perform one of the following services: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center and personnel. There have been no interpretive regulations promulgated for this subsection. Congressional reports are quoted to show that the omission of "ordinary, general and commercial" laundry services from the list was intentional.

> The Court believes it to be true that the Congress intentionally omitted ordinary, general and commercial laundry services from the blanket exemption granted to hospital cooperatives in Section 501(e). It does not follow, however, that the addition of Section 501(e) excludes UHS from consideration as a Section 501(c)(3) charitable organization on its own merits. UHS has consistently maintained in its claim for refund and in its briefs that Section 501(c)(3) applies. The question of whether it is organized and operated for an exempt purpose is a question of fact for this Court to decide. Underwriters' Laboratories v. C.I.R., 135 F.2d 371 (7 Cir. 1943).
>
> UHS was incorporated and doing business some years before Section 501(e) was adopted in 1968. It was either a charitable organization before 1968, under then existing law, or it was not. The Court holds that it was, for reasons above and hereafter set out. The clearly expressed Congressional purpose behind the enactment of Section 501(e) was to enlarge the category of charitable organizations under Section 501(c)(3) to include certain cooperative hospital service organizations, and not to narrow or restrict the reach of Section 501(c)(3). The latter section was not modified by the legislation in any way, and the legislation does not purport to take away charitable status from a corporation which had already acquired it. Insofar as this case is concerned, therefore, Section 501(e) is irrelevant.

384 F. Supp. at 780, 781.

A federal district court in *Hospital Central Service Association v. United States*, 77-2 U.S.T.C., P 9601, 40

A.F.T.R.2d 77-5646, accepted Judge Dillin's analysis without further comment.

Defendant nonetheless argues that *United Hospital* and *Hospital Central* are distinguishable from the instant case in that those cases held exempt laundry service organizations incorporated before the enactment of Section 501(e). This argument is not persuasive for two reasons. First, although the organizations were incorporated before 1968, they were granted a refund on taxes paid out after Section 501(e) was fully in effect (1971 for *United Hospital* and 1974 for *Hospital Central*). Second, it appears that Judge Dillin in *United Hospital* referred to the 1964 date of incorporation simply to illustrate his point that Section 501(c)(3) operated independently of Section 501(e) in defining various exemptions. Certainly, the holding in *United Hospital* that Section 501(e) enlarged rather than restricted the exemptions already afforded by Section 501(c) did not depend upon the court's observation that the laundry service in question was incorporated before 1968.

I hold, therefore, that Section 501(e) does not preclude Metropolitan from receiving a general charitable exemption under 501(c)(3) provided it meets the qualifications for exemption under the section. It is this issue which is next discussed.

II.

Plaintiff contends that it is a charitable organization within the meaning of Section 501(c)(3), and, therefore entitled to a Section 501(a) tax exemption. Defendant counters that since plaintiff offers services normally provided by commercial rather than charitable organizations it cannot receive a charitable exemption.

That plaintiff provides a service frequently offered by commercial establishments does not preclude its classification as a charitable organization. Nursing homes, hospitals and service organizations operated as charities frequently compete vigorously with their commercial counterparts for the same business. Plaintiff's organization as a laundry service, therefore, does not preclude it from receiving a charitable exemption provided it can meet the somewhat amorphous definitional requirements:

> "The term 'charitable' is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of 'charity' as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes . . ."

Treas. Reg. § 1.501(c)(3)-1(d)(2).

In determining whether a particular organization falls within this definition courts consider both the general policy behind Section 501(c)(3) and those pertinent factors which, in a given case, suggest that the organization is charitable:

> Usually, provisions allowing for exemptions from taxation are strictly construed against those

claiming such exemptions. Conference of Major Religious Superiors of Women, Inc. v. District of Columbia, 121 U.S. App. D.C. 171, 348 F.2d 783 (1965). But in cases involving charitable purposes, provisions giving tax exemptions are liberally construed. American Institute for Economic Research v. United States, 302 F.2d 934, 157 Ct. Cl. 548 (1962), cert. den. 372 U.S. 976, 83 S.Ct. 1109, 10 L.Ed.2d 141, rehearing den. 373 U.S. 954, 83 S.Ct. 1677, 10 L.Ed.2d 708 (1963); Harrison v. Baker Annuity Fund, 90 F.2d 286 (7th Cir. 1937). Ambiguity of these provisions has been traditionally resolved against taxation. C. F. Mueller Co. v. Commissioners, 190 F.2d 120 (3 Cir. 1951).

In determining the tax status of an organization, courts look to the predominant purpose for forming the organization and its manner of operations. Passaic United Hebrew Burial Ass'n v. United States, 216 F. Supp. 500 (D. N.J. 1963). The organization's right to an exemption depends largely upon how its operations affect the public. People's Educational Camp Society, Inc. v. Commissioner, 331 F.2d 923 (2 Cir.), cert. den. 379 U.S 839, 85 S.Ct. 75, 13 L.Ed.2d (1964). The organization must exclusively perform essential public services. Horace Heidt Foundation v. United States, 170 F. Supp. 634, 145 Ct. Cl. 322 (1959). The fact that an organization produces income to retire its indebtedness does not disqualify it from being tax-exempt. Shiffman v. Commissioner, 32 T.C. 1073 (1959).

384 F. Supp. at 779.

I agree with Judge Dillin's analysis of the policy supporting Section 501(c)(3) and find the following factors in this case indicative of Metropolitan's charitable nature and purposes: (1) Metropolitan is governed by a Board of Trustees the members of which also serve on governing boards of the various participating hospitals. Consequently, hospital members collectively control and operate Metropolitan in their own interest; (2) All members receive a benefit from Metropolitan's centralized, standarized services, including reduced costs and increased floor space; (3) For profit hospitals are not permitted to participate in the cooperative and no profits (as that term is traditionally defined) are realized by Metropolitan; (4) Metropolitan provides a service which is essential to the proper functioning of its tax exempt members. Indeed, prior to the incorporation of Metropolitan each member hospital performed these services independently through "in-house" laundries; (5) The Articles of Incorporation of Metropolitan provide that upon its dissolution all proceeds shall be distributed to charitable organizations exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.

As the courts held in *United Hospital* and *Hospital Central,* I find that a non-profit laundry cooperative organized such as Metropolitan is a charitable organization entitled to an exemption because of Sections 501(c)(3) and 501(a) of the Internal Revenue Code.

III.

Defendant also argues that plaintiff's motion for summary judgment should be denied because plaintiff is a feeder organization as defined in Section 502 of the Internal Revenue Code, and, therefore, not entitled to an exemption under Section 501(a). Section 502 provides:

> (a) General rule. — An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.
>
> (b) Special rule. — For purposes of this section, the term "trade or business" shall not include —
>
> > (1) the deriving of rents which would be excluded under section 512(b)(3), if section 512 applied to the organization,
> >
> > (2) any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or
> >
> > (3) any trade or business which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

See also Treas. Reg. § 1.502-1.[2]

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[2] § 1.502-1 Feeder organizations

(a) In the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed

(continued on following page)

In both *United Hospital* and *Hospital Central* it was held that cooperative, non-profit laundry services (like Metropolitan) were not feeder organizations within the meaning of Section 502. I agree that a hospital laundry

(continued from preceding page)

under section 501 on the ground that all the profits of such organization are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501.

(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt education organization, in carrying on its education activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For purposes of this paragraph, organizations are related only if they consist of —

(1) A parent organization and one or more of its subsidiary organizations; or

(2) Subsidiary organizations having a common parent organization.

(c) In certain cases an organization which carries on a trade or business for profit but is not operated for the primary purpose of carrying on such trade or business is subject to the tax imposed under section 511 on its unrelated business taxable income.

service organization which realizes no profit and operates exclusively for the benefit of tax exempt hospitals cannot reasonably be defined as a trade or business operated for profit under Section 502. Moreover, according to Treas. Reg. 1.502-1 those businesses denied exempt status under Section 502 must be "unrelated" trades or businesses to the charities they feed. Since a laundry service is directly related to the successful functioning of a hospital, I cannot find that Metropolitan falls within the definition of non-exempt services under Section 502.

An additional issue merits discussion here. In *United Hospital* the court placed weight upon its finding that the hospital laundry service involved there did not compete with commercial laundries in the area. This factor played a part in the court's finding that the laundry service was a charitable organization within the meaning of Section 501(c)(3); it also appears to have played a part in the court's refusal to classify the laundry as a feeder organization under section 502. In *Hospital Central* the defendant did not contest the plaintiff's representation that the laundry service there performed such a unique function that it did not compete with commercial laundries in the area. The court, therefore, found it unnecessary to analyze the significance or insignificance of the no competition factor.

In this case plaintiff contends, in affidavits in support of its motion for summary judgment, that Metropolitan provides unique laundry services not offered by commercial establishments. Defendant, in opposing affidavits, states that commercial laundries in the Detroit area provide services "similar" to those offered by Metropolitan and actively compete with Metropolitan for hospital laundry business.

If a charitable organization was defined in part by its failure to compete with profitable businesses it would be necessary to hear evidence relating to the competition question raised by the parties in their affidavits. Similarly, if non-competition with profitable trades or businesses was a prerequisite to exclusion from the definition set forth in Section 502, I would hear evidence on this issue. However, as stated above, the competitive or non-competitive nature of an organization neither restricts nor expands its definition as a charity. Furthermore, a cursory study of Section 502 and Treas. Reg. 1.502-1 suggest that the competition factor is also irrelevant in defining an organization as a feeder. Defendant may be correct in suggesting that the general purpose behind the enactment of section 502 was to restrict competition between charitable and profitable enterprises. Nevertheless, defendant cannot ask this court to classify an organization as a feeder to further Congress' purposes where, as here, the organization in question does not nearly meet the clear definitional language in the statute itself.

I find, therefore, that whether Metropolitan competes with commercial laundries is irrelevant to the holding of this court. Accordingly, summary judgment for the plaintiff is granted. An appropriate order is entered contemporaneously herewith.

/s/ JOHN FEIKENS
UNITED STATES DISTRICT JUDGE

DATE: February 8, 1978
Detroit, Michigan.

ORDER

(United States District Court
Eastern District of Michigan
Southern Division)

(Metropolitan Detroit Area Hospital Services, Inc., a Michigan non-profit corporation, Plaintiff, v. United States of America, Defendant. Civil Action No. 7-70794)

At a session of said Court held in the Federal Building, Detroit, Michigan, on February 8, 1978.

Present: Honorable John Feikens
United States District Judge

On filing the opinion dated this same day, and for the reasons contained therein.

IT IS ORDERED that plaintiff's motion for summary judgment be and it is hereby GRANTED.

/s/ John Feikens
UNITED STATES DISTRICT JUDGE

JUDGMENT

(United States District Court
Eastern District of Michigan
Southern Division)

(Metropolitan Detroit Area Hospital Services, Inc. a Michigan non-profit corporation, Plaintiff, vs. United States of America, Defendant. Civil Action No. 770794)

THIS MATTER came on for consideration before the undersigned Judge of the above-entitled Court upon the motion of Metropolitan Detroit Area Hospital Services, Inc., plaintiff herein, for summary judgment, and the Court having issued its Opinion making a determination that there was no genuine issue as to any material fact and that plantiff be entitled to judgment as a matter of law, and having issued its Order granting plaintiff's motion for summary judgment,

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that plaintiff recover judgment against the United States of America in the sum of $44,633.00, plus interest in accordance with law.

/s/ Fred W. Kaess
United States District Judge
for & in the absence of Judge John Feikens

APPENDIX B

Nos. 78-1205; 78-1218

(United States Court of Appeals
For the Sixth Circuit)

(Metropolitan Detroit Area Hospital Services, Inc., Plaintiff-Appellee, v. United States of America, Defendant-Appellant.)

Appeal from the United States District Court for the Eastern District of Michigan, Southern Division.

Decided and Filed November 4, 1980

Before: KEITH and MERRITT, Circuit Judges, and PECK, Senior Circuit Judge.

Keith, Circuit Judge. Plaintiff Metropolitan Detroit Area Hospital Services, Inc. (Metropolitan) is a non-profit corporation owned and operated cooperatively by six Detroit area hospitals. Its purpose is to provide laundry services to member hospitals. Prior to the incorporation of Metropolitan on June 15, 1970, each participating hospital maintained separate "in house" laundry facilities to furnish the services now provided by Metropolitan. In essence, the hospitals pooled their resources to form the laundry cooperative, and now pay to Metropolitan a rate designed to cover the laundry's costs and overhead, including debt retirement.

At present, Metropolitan provides laundry service only.[1] Metropolitan is controlled by a Board of Trustees, the members of which are appointed by the governing bodies of the participating hospitals. Each hospital

[1] However, the Articles of Incorporation allow for a significant expansion of hospital services.

appoints two members to Metropolitan's Board. Each participating hospital is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code, 26 U.S.C. 501(c)(3). Each hospital is publicly owned and operated as a municipal corporation. Metropolitan is exempt from Michigan *ad valorem* personal and real property taxes and from Michigan sales tax. M.C.L.A. 211.7; *Hospital Purchasing Services v. City of Hastings*, 11 Mich. App. 500, 161 N.W. 2d 759 (1968)

In 1973, Metropolitan paid $4,811.00 in federal income taxes. The pleadings do not show what amount, if any, Metropolitan paid in income taxes for 1974. In 1975, it paid $39,822.00. On April 17, 1975, Metropolitan filed with the Internal Revenue Service an application for recognition of exemption, asserting that it was a charitable organization under Internal Revenue Code 26 U.S.C. § 501(c)(3) and, thus, entitled to federal income tax exemption under § 501(a) of the Code. The IRS denied Metropolitan the exemption on September 1, 1976 and on February 11, 1977, informed Metropolitan that it had found insufficient grounds upon which to reduce Metropolitan's tax liability.

On April 1, 1977, Metropolitan filed its complaint in the district court against the IRS to recover $44,633.00. The basis for the refund claim was that Metropolitan was entitled to a tax-exempt status. The district court granted summary judgment, pursuant to Fed.R.Civ.P. 56 in favor of Metropolitan. The United States brought this appeal.

The stated facts are undisputable by the parties. The only question demanding resolution is whether, under these facts, the plaintiff is entitled to a federal income tax exemption under Section 501(a) because of a tax exempt status under Section 501(c)(3) of the Internal Revenue Code.

I.

There are two code provisions that are relevant for our discussion of this tax problem. Section 501(c)(3) grants a tax exemption to all organizations that are:

> "organized and operated exclusively for religious, charitable, scientific or educational purposes . . . [and] no part of the earnings of which inure to the benefit of any private shareholder or individual." I.R.C. § 501(c)(3)[2]

Metropolitan claims that it is organized for a charitable purpose, and therefore is exempt under this section of the Code.

Section 501(e) is the second provision that we must consider. Section 501(e) specifically addresses the tax-exempt status of those cooperatives formed by § 501(c)(3) tax-exempt hospitals. The government contends that § 501(e) is the controlling statutory section. Our goal is to ascertain the intent of Congress in enacting § 501(e).

Section 501(e) provides in pertinent part:

> (e) Cooperative hospital, services organizations — for purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if —
>
> (1) such organization is organized and operated solely —
>
> (A) to perform on a centralized basis, one or more of the following of services which, if

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[2] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as in effect during the years at issue.

performed on its own behalf by a hospital which is an organization described in Subsection (c)(3), and would be exempt from taxation under Subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is —

(i) an organization described in Subsection (c)(3) which is exempt from taxation under Subsection (a),

(ii) a constituent part of an organization described in Subsection (c)(3) which is exempt from taxation under Subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in Subsection (c)(3), or

(iii) owned and operated by the United States, a state, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

> (2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and
>
> (3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.
>
> For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in Subsection (c)(3) and exempt from taxation under Subsection (a) shall be treated as a hospital and as an organization referred to in Section 170(b)(1)(A) (iii).

The district court found for the taxpayer, holding that Metropolitan met the requirements of § 501(c)(3) as a charitable organization, and thus was entitled to tax exempt status under Section 501(a). In answering the question of whether Metropolitan was a § 601(c)(3) organization, the district court used a three-pronged analysis. First the court inquired whether the taxpayer was entitled to claim a tax exemption directly under 501(c)(3) or whether it was limited to Section 501(e). Assuming Metropolitan was so entitled, the court next inquired whether it was in fact a § 501(c)(3) organization? And finally, the court inquired whether § 502, the "feeder provision," could block any exemption to which Metropolitan might otherwise have been entitled? The government appeals from the holding that Metropolitan is a § 501(c)(3) organization, and argues that § 501(e) is the controlling statutory provision.

On appeal the question before us is whether § 501(e) specifically limits the type of hospital cooperative

services that may be treated as a tax exempt § 501(c)(3) organization. If answered in the affirmative, our inquiry is complete. A cursory reading of 501(e) reveals that laundry services are absent from the inventory of hospital cooperatives singled out for tax exempt treatment. From this one might infer that Congress intended to exclude laundry service from tax exempt treatment.[3] However, some lower courts have not so interpreted this omission.[4] Rather, Section 501(e) has

[3] *See* Rev. Rul. 69-160 G.B. 1969-I, 147; Rev. Rul. 69-633. In pertinent part, Revenue Ruling 69-633 states:

> Situation 1: A number of hospitals exempt from federal income tax under Section 501(c)(3) of the Code formed a laundry service organization. The organization was organized and operated on a cooperative basis to serve only the hospitals that organized it. All net earnings are required to be allocated or paid to patrons on the basis of services performed for them.
>
> Question 1: Can the organization qualify for exemption from Federal Income Tax as a cooperative hospital service organization under Section 501(c)(3) of the Code by reason of Section 501(e)?
>
> Answer: In order to qualify as a cooperative hospital service organization under the provisions of Section 501(e) of the Code, an organization must be organized and operated solely to perform one or more of the services specified in Section 501(e)(1)(A) of the Code. Since laundry services are not one of the services specified in that section, the organization does not meet the requirements of Section 501(e) of the Code and thus is not exempt from Federal income tax under Section 501(c)(3). See Rev. Rul. 69-160, G.B. 1969-1, 147.

See also H.R. Rep. No. 1533, 90th Cong., 2d Sess. 43 (1968); Committee of Conference on H.R. 15414, 90th Cong., 2d Sess. Revenue and Expenditures Control Act of 1968. Explanation of the Bill H.R. 15414. As agreed to in Conference 20 (Comm. Print 1968).

[4] *See, e.g., Community Hospital Services, Inc.* v. *United States*, 79 U.S.R.C. § 930ı (E.D. Mich 1979); *Hospital Central Services Association* v. *United States*, 77-2, U.S.T.C. § 9601 (W.D. Wash. 1977); *Hospital Bureau of Standards and Supplies, Inc.* v. *United States*, 158 F.Supp. 560 (Ct. Cl. 1958).

been held to be a "safe harbor" for those hospital services so catalogued.[5] Under this view, the fact that laundry services are outside § 501(e) is irrelevant.

This interpretation enables a hospital laundry cooperative to apply for and receive a § 501(c)(3) exemption under the theory that clean laundry is integrally related to the delivery of health services. In other words, clean laundry is indispensable to the proper functioning of any hospital providing modern health care. The district court specifically found that Metropolitan, the non-profit laundry cooperative; satisfied the requirements for § 501(c)(3) charitable organization and was therefore entitled to a tax exemption.

In determining that §501(c)(3) of the Code applied to Metropolitan, the district court enumerated the following factors indicative of Metropolitan's charitable nature and purposes:

> (1) Metropolitan is governed by a Board of Trustees, the members of which also serve on governing boards of the various participating hospitals. Consequently, hospital members collectively control and operate Metropolitan *in their own interest*; (2) All members receive a benefit from Metropolitan's centralized, standardized services, including reduced costs and increased floor space; (3) For-profit hospitals are not permitted to participate in the cooperative *and no profits (as that term is traditionally defined)* are realized by Metropolitan; (4) Metropolitan provides a service which is essential to the proper

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[5] *See Metropolitan Detroit Area Hospital Services, Inc.* v. *United States*, 445 F.Supp. 857, 860 (E.D. Mich 1978).

> functioning of its tax exempt members. Indeed, prior to the incorporation of Metropolitan each member hospital performed these services independently through "in-house" laundries; (5) The Articles of Incorporation of Metropolitan provide that upon its dissolution all proceeds shall be distributed to charitable organizations exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.[6]

Apparently the lower court was persuaded that the above factors brought Metropolitan within the charitable purpose rubric of § 501(c)(3). The twin findings by the district court that 501(e) was meant to be only a "safe harbor" for hospital cooperatives and that this laundry was a charitable organization constitute the basis for the holding that Metropolitan is entitled to an exemption under 501(a).

Our examination of the legislative history of Section 501(e) compels us to reverse the district court.[7] We believe that 501(e) was intended by Congress to be a definitive inventory rather than merely a descriptive list of hospital cooperatives. Thus, we hold that the omission of laundry services from 501(e) defeats Metropolitan's claim for tax exempt status.

In 1968, the Senate drafted an amendment to the Tax Adjustment Bill of 1968 which proposed to treat the majority of those organizations formed by tax exempt hospitals as charitable organizations.[8] Under this

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[6] District Court's Memorandum at *Metropolitan Detroit Area Hospital Services, Inc.* v. *United States*, 445 F.Supp. 857, 862 (E.D. Mich. 1978).

[7] See n. 3 *supra*.

[8] Moreover, the Tax Reform Act of 1976, Pb. 1 94-455, 90 Stat. 1520, contained an amendment to Section 501(e) which would have included laundry services within the services specified in Section 501 (e). It was deleted from the Tax Reform Act on the floor of the Senate. *See* 122 Cong. Rec. 25915 (1976).

amendment, laundry services would have been included as a charitable organization. However, the House did not pass this all-encompassing amendment and the matter had to be resolved by a Conference Committee. A substitute amendment endorsed by the Conference Committee was ultimately passed by Congress. The report from the Conference Committee reads:

> The new subsection *does not grant tax exempt status* if the hospital service organization performs any services other than those specified in the new subsection (for example, laundry services), or performs any services for any person or organization other than a tax exempt hospital. H.R. Rep. No. 1533, 90th Cong., 2d Sess. 43 (1968) (emphasis added).

Moreover, the statements of Congressional leaders made interpreting the Conference Committee report eliminate any ambiguity concerning the status of laundry services. For example, the Honorable George A. Smathers, the ranking member of the Senate Committee on Finance stated:

> "The conferees agreed to the Senate provision . . . but limited the exemption to a joint enterprise which is organized and operated solely to perform data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications or personnel functions for hospitals. 114 Cong. Rec. § 7480 (1968) (remarks of Sen. Smathers) *reprinted in* [1968] U.S. Code Cong. & Ad. News 2422, 2427.

It is an elementary rule of statutory construction that a specific provision controls when the same subject matter

is addressed by a more general provision."[9] Appellee contends that Metropolitan qualifies for 501(c)(3) treatment on its own merits, but to hold that a hospital cooperative can qualify under 501(e) would be to attribute to Congress the passing of a superfluous statute. Therefore, we find that a tax exemption is available for a cooperative under 501(c)(3) only if it is one of the cooperatives listed in 501(e).

Congress has restricted the proliferation of hospital cooperatives by specifically naming the cooperatives entitled to receive 501(c)(3) treatment. Laundry cooperatives were not so favored. As the government aptly observes, granting mutual laundry organizations exemptions under § 501(c)(3) permits a greater or more substantial tax advantage than that provided § 501(e) shared service organizations.[10] This would be contrary to

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[9] "[I]t is familar law that a specific statute controls over a general one without regard to priority of enactment." *Bulova Watch Co.* v. *United States*, 365 U.S. 753, 758 (1961). *See also Nitzeberg* v. *Commissioner*, 580 F.2d 357 (9th Cir. 1978).

[10] For example if a § 501(c)(3) organization, in addition to performing the function constituting the basis for its exemption, regularly carries on a "trade or business . . . not substantially related to its charitable function," it will not lose its exemption but rather will be taxed on unrelated business income under § 511. However, the § 501(e) organization which regularly carries on a business will not be able to retain its exemption and be taxed only on the unrelated business income. Instead, it will be in danger of not qualifying for the exemption. Code § 513(e) gives a two-prong test for the imposition of the unrelated business income tax: a business activity which (1) regularly carried on and (2) not substantially related to the exempt purposes of the organization. *See also* Rev. Rul. 69-160, 1969-1. Cum. Bull. 147.

Congressional intent to withhold even the more limited § 501(e) benefits from them. The conclusion seems inescapable that Congress has determined that mutual laundries should not be treated as an organization "organized and operated exclusively for charitable purposes."

We find that § 501(e) precludes Metropolitan from being considered on its own merits as a § 501(c)(3) charitable organization. Section 501(e) states that an organization under 501(e) "shall be treated" as an organization organized and operated exclusively for charitable purposes. Implicit in the wording of the statute itself is the idea that such cooperatives are not themselves "organizations" organized exclusively for charitable purposes,[11] although Congress did choose to have certain cooperatives treated as though they were so organized and operated. We believe it is unfortunate that § 501(e) acts as a disincentive for the sharing, among non-profit hospitals, of laundry and other necessary costs, but this policy decision to exclude laundry service cooperatives from tax exempt treatment is well within the sphere of legislative prerogative. Congress might well wish to reconsider this decision.

We are not alone in concluding that the legislative intent in excluding laundry services manifested a specific Congressional purpose. Recently the Third Circuit in *HCSC-Laundry v. United States*, — F.2d — 3rd Cir. No. 78-1409 (June 6, 1980) held that the "legislative history supports the Internal Revune Service's position that the statute reflects an explicit manifestation of legislative judgment and purpose not to "*afford*

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[11] *See generally*, Tuthill, *Qualifying as a Tax Exempt Cooperative Hospital Service Organization*, 50 Notre Dame Laywer 448 (1975).

cooperative hospital laundries tax exempt status." Id. at 15 (emphasis supplied).[12]

For the reasons stated above, the judgment of the district court is reversed. Each party is to bear its own costs.

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[12] The Ninth Circuit adopted this position in a *per curiam* opinion:

> A group of charitable § 501(2)(3) hospitals may jointly create and own a tax-exempt entity under § 501(e)(1)(A) to perform certain functions: e.g. computer service, purchasing, warehousing, laboratory, printing, billing and collecting, and other services listed in § 501(e)(1)(A) of the Code. The issue is whether, under § 501(c)(3), the hospitals may create tax-exempt entities to perform services not listed in § 501(e)(1)(A).
>
> After a careful examination of the legislative history of § 501(e)(1)(A) and of established legal principles which we need not repeat here, the Third Circuit held that Congress had intentionally omitted laundry services from the list of commercial services for which charitable hospitals could form jointly-owned entities that would be tax exempt.
>
> Whether the legislative decision to favor the commercial laundry industry by removing a tax advantage from competitors was a wise or equitable decision is obviously not a judicial question. On the only judicial question — the meaning of the tax law — we agree with the Third Circuit for the reasons stated in its opinion.
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> *Hospital Central Services, Assoc.* v. *United States of America*, No. 77-3701 (9th Cir. July 21, 1980).

APPENDIX C

JUDGMENT

(United States Court of Appeals
For the Sixth Circuit)

(Filed Nov. 4, 1980)

Nos 78-1205
78-1218

(Metropolitan Detroit Area Hospital Services, Inc., Plaintiff-Appellee, v. United States of America, Defendant-Appellant.)

Before: KEITH: MERRITT, Circuit Judges, and PECK, Senior Circuit Judge.

APPEAL from the United States District Court for the Eastern District of Michigan.

THIS CAUSE came on to be heard on the record from the United States District Court for the Eastern District of Michigan and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed.

Each party to bear its own costs.

ENTERED BY ORDER OF THE COURT.

/s/ JOHN P. HEHMAN, Clerk

Issued as Mandate: December 29, 1980

COSTS: None